MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

Washington Monthly Report

Mandatory Social Security

Some observers already have declared Social Security reform dead for the year. House Republicans are divided among themselves about whether to support their own proposal, developed by House Ways and Means Chairman Bill Archer (R-Tex.) and House Ways and Means Social Security Subcommittee Chairman Clay Shaw (R-Fla.). The House GOP Leadership has indicated its clear lack of enthusiasm for taking up Social Security reform this year in the wake of an internal GOP poll suggesting that the issue could backfire with voters and jeopardize the narrow GOP majority in the House. Senate Majority Leader Trent Lott (R-Miss.) went so far as to publicly declare that the Senate would not take up Social Security reform this year.

Things have not been any more cohesive on the other side of the partisan fence. The President's approach of Universal Savings Account has failed to spark much enthusiasm among Senate Democrats or among many Democrats in the House, and no visible Democratic alternative has surfaced in the House.

All the while, time slips away in the Congressional session, as Congress soon will have to turn its attention in earnest to moving the 13 appropriations bills necessary to keep the government operating in the new fiscal year beginning October 1 and to writing tax cut legislation by mid-July.

Does this mean it is time to go home on the mandatory Social Security issue? The answer is not. Both sides have a fair amount invested in the issue -- and most importantly each side fears being blamed for being the first to walk away from the issue empty-handed. While Congress does not have much of a recent track record of the type of bipartisan cooperation that would be necessary to move broad-ranging Social Security reform, the legislative outlook on a host of big-ticket budget issues, including tax and appropriations legislation, is in such flux that almost anything could happen, including another omnibus budget deal at the end of the Congressional session.

So the answer is that the State and local government community should continue to vigorously mount grassroots opposition to mandatory coverage of State and local workers as a Social Security reform option. The grassroots message has registered quite effectively with the California Congressional delegation. This grassroots message must continue to be pressed until it is clear beyond cavil that Social Security reform is dead for the year. Further, even if Social Security reform legislation does not take shape this year, vigorous and persistent opposition to mandatory Social Security coverage for State and local workers this year could help deter efforts to inject mandatory coverage into future Social Security reform debates.

The Senate letter to the President opposing mandatory State and local coverage, organized by Senator Feinstein and Senator George Voinovich (R-Ohio), has now gone to the White House with a bipartisan group of 12 Senators on it. (Copy attached). Both California Senators signed the letter. While it would have been desirable to have the participation of all of the Senators from the non-covered States, this is a start.

In developments since last month's report, House Ways and Means Chairman Archer and Social Security Subcommittee Chairman Shaw finally released their long-awaited Social Security reform package. As noted above, many House GOP Members, including their own leadership, were less than enthusiastic about the proposal. House Speaker Dennis Hastert (R-Ill.), for example, characterized the proposal as "one of a number of good ideas, and hopefully more good ideas will be offered."

In a nutshell, the Archer-Shaw package relies on the projected federal budget surplus in general revenues to finance an "individual account" mechanism which would be invested in equities and bonds. According to Archer and Shaw, this approach preserves the long-term solvency of the Social Security trust fund without having to turn to payroll tax increases or benefit cuts.

The Archer-Shaw package would establish "personally-controlled Social Security Guarantee Accounts." These would be funded each year by means of a refundable income tax credit automatically deposited into the worker's account. The amount deposited each year would be equal to 2 percent of the worker's wages, up to a maximum credit of $1,452 (*i.e.*, 2 percent of wages up to the Social Security wage base maximum of $72,600).

While the worker could select from among 50 investment options, he or she would be required to invest the account balance in funds made up 60 percent of broadly-indexed stocks and 40 percent of bonds. The 60/40 split in asset allocation has been projected by the proposal's sponsors to produce a 5.35 percent average rate of return, after taking into account administrative costs. [So much for the "underperforming, lagging, politicized" State and local government pension plans with their historic investment returns of a mere two to three times greater -- But, we digress.] Administrative costs have been estimated by the sponsors at 25 basis points of the account balance. The worker could not touch the account until normal retirement or disability retirement. The account balance would pass to the worker's heirs if death occurs before retirement.

At the time of retirement, the account balance would be annuitized. The Social Security system then would make up the difference between the annuity benefit from the "private account" and the monthly Social Security benefit due under current law. While the worker nominally would be entitled to a portion of any "upside" by which the annuitized amount actually exceeded the Social Security monthly benefit, the projected 5.35 percent average annual rate of return makes any such "upside" problematic.

Whatever its technical actuarial implications, the Archer-Shaw proposal may face difficult marketing hurdles in appealing to the general public. While the individual worker has his or her own account and account balance, that is about it. The annual contribution amount is set by statute. The asset allocation is fixed. The account cannot be tapped prior to retirement. Then, at retirement, the account must effectively be handed back to the federal government as an offset to the Social Security benefit under current law.

The Archer-Shaw proposal thus far has been presented in concept only, and has yet to be introduced in legislative language. The President's proposal also has been proffered in concept only. However, House Democrats recently met with the President and vowed to pursue his plan as legislation, to be presented within the next month. The President and House Democrats, including Ways and Means ranking Democrat Charles Rangel (D-NY), also made some tentative overtures of bipartisan cooperation to the House Republicans. Reportedly, though, Rep. Rangel raised Chairman Archer's hackles in the process by dismissing the Archer-Shaw plan as mere "chit chat" because it had yet to be reduced to legislative language. As you can see, this group does not naturally play well together.

In the meantime, the House Republican leadership has decided to seek some cover on the Social Security reform issue by bringing up on the House Floor a so-called "lockbox" measure (H.R. 1259) drafted by Ways and Means Republican Wally Herger (R-Calif.). The measure would reserve the surplus in the Social Security trust fund into a "lockbox" in the sense that the surplus could not be tapped for general government spending, as has happened so frequently in the past. Any such effort to tap the Social Security trust fund for general spending would be subject to a point of order on the House and Senate Floors. However, such a point of order could be overturned by a vote of the House and Senate, leading critics to charge that the enforcement mechanism for the "lockbox" is weak in light of the regularity with which points of order under current budget law are overruled by House and Senate votes. The Herger measure also would remove Social Security payroll tax receipts from overall, unified federal budget surplus and deficit calculations, meaning that the federal budget actually would have run a deficit in the current fiscal year instead of the widely-touted surplus. Democrats in the Senate have been filibustering a similar "lockbox" proposal over there, and hence the prospects for the "lockbox" approach seem problematic.

In an encouraging development on another front, Reps. Jim Kolbe (R-Ariz.) and Charles Stenholm (D-Tex.), who last year introduced broad-ranging Social Security reform legislation that imposed painful benefit cuts such as raising the Social Security retirement age to 70 and cutting spousal benefits as well as mandating coverage of State and local workers, announced that because of the controversy over mandatory State and local coverage they were dropping it from this year's proposal prior to introduction. The Kolbe-Stenholm bill (H.R. 1793) was then introduced on May 13.

Accordingly, for all of its fits and starts and uneven coordination as a group, the State and local government community has managed to successfully avoid inclusion of mandatory State and local coverage in the major Social Security reform plans that has surfaced thus far this year -- the President's plan, the Archer-Shaw plan, and the Kolbe-Stenhom plan -- with the exception of the Moynihan-Kerrey plan in the Senate which does not seem to be going anywhere fast.

On the Social Security offset front, Rep. Bill Jefferson (D-La.), a junior Democrat on the House Ways and Means Committee, has introduced, along with 130 House co-sponsors, H.R. 1217 to modify the Governmental Pension Offset. This offset currently reduces the Social Security spousal benefit of a Federal, State, or local government employee who is receiving a government pension from work not covered by Social Security. The Senate counterpart legislation is S. 717, introduced by Sen. Barbara Mikulski (D-Md.).

Rep. Jefferson's bill would limit the "offset" or reduction in the Social Security benefits of spouses to two-thirds of the amount by which the combined monthly Social Security and government pension benefit exceeds $1,200 per month, rather than reducing the Social Security spousal benefit by two-thirds of the full monthly government pension benefit. Notwithstanding the broad support for the legislation by rank-and-file House Members, its cost has proven to be prohibitive in the past and is likely to continue to be so. Moreover, such legislation is unlikely to move ahead of Social Security reform legislation.

Elk Hills Appropriation

Now that the first $36 million installment of Elk Hills compensation actually has been received and is burning a hole in STRS's pocket, the task at hand is to gain Congressional approval of the next $36 million installment due for the upcoming FY 2000.

As reported earlier, we worked with Rep. Thomas's office to secure the signatures of the entire 52 Member California delegation in the House on a strong letter of support for the Elk Hills appropriation to House Appropriations Committee Chairman Bill Young (R-Fla.) and Interior Appropriations Subcommittee Chairman Ralph Regula (R-Ohio). Reportedly, this letter has made a real impression at the Appropriations Committee, and we are not encountering the ranting and raving of vociferous opposition that we had to overcome last year. However, that being said, unless the budget spending caps are raised for the FY 2000 appropriations from their current draconian levels, we are likely to face a very uphill battle because there simply will not be enough money to go around, even for such prized programs as the national parks.

In the meantime, we are continuing to work with the California Members who sit on Appropriations, particularly those on the Democratic side in an effort to fill the large void created by the retirement of our long-time influential supporter on that side, Rep. Vic Fazio (D-Sacramento). The California Republicans on House Appropriations include Reps. Jerry Lewis (Redlands), Ron Packard (San Clemente), and Duke Cunningham (Escondido). Democrats on the Committee include Reps. Julian Dixon (Los Angeles), Nancy Pelosi (San Francisco), Lucille Roybal-Allard (Los Angeles), and Sam Farr (Santa Cruz).

On the Senate side, Senator Feinstein now sits on the Senate Interior Appropriations Subcommittee and is supporting Elk Hills funding on the Senate side.

Current indications are that the Interior Appropriations bill will not be considered until later in the summer, perhaps in July.

With our New Best Friend, Energy Secretary Bill Richardson, now having so visibly claimed credit for securing last year's Elk Hills funding, we would hope that the Energy Department actually will help us this time around in the appropriations battle.

John S. Stanton

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